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October 15, 1990

Mr. Jim Dodd  
Appraiser Analyst III  
Office of the Assessor  
County of Ventura  
800 South Victoria Avenue  
Ventura, CA 93009

Dear Mr. Dodd:

I am writing in response to your letter dated February 7, 1990, wherein you request our opinion on the change in ownership consequences of two hypothetical transactions. The two hypothetical transactions are described and analyzed separately below:

Hypothetical No. 1

Facts

1. Partnership owns real property.
2. Partnership, in turn, is owned 60% by corporation A (parent corporation), 25% by corporation B (subsidiary corporation) and 15% by various individuals.
3. Corporation B is a wholly owned subsidiary of parent corporation A.
4. Parent corporation A proposes to transfer all of its interest in the partnership to subsidiary corporation B, which will then own 85% of the partnership.

Law and Analysis

All code references are to the Revenue and Taxation Code unless otherwise expressly stated.

When a corporation, or other legal entity or person, obtains a majority ownership interest in a partnership through the acquisition of partnership interest, the acquisition shall constitute a change of ownership of property owned by the partnership. (Section 64(c). See also Rule 462(j)(4)(A) of the Property Tax Rules of Title 18 of the California Code of Regulations.)

However, an exception exists if the transaction qualifies as a "corporate reorganization, where all of the corporations involved are members of an affiliated group, and which qualifies as a reorganization under Section 368 of the United States Internal Revenue Code and which is accepted as a nontaxable event by similar California statutes...." (section 64(b).)

Since corporation A proposes to transfer its interest in the partnership to corporation B, the portion of section 64(b) which refers to "any transfer of real property among members of an affiliated group" is inapplicable.

In this case, 100% of the stock of corporation B is owned by corporation A, so A and B are members of an affiliated group for purposes of section 64(b). However, you have not indicated whether or not the hypothetical transaction will qualify as a tax-free reorganization under I.R.C., section 368 and similar state statutes. If the proposed transaction will qualify as a tax-free reorganization, it will be excluded from change in ownership consequences under section 64(b).

If the proposed transaction will not so qualify, however, it still may be exempt from reappraisal if the requirements of section 62(a)(2) are satisfied. Pursuant to section 62(a)(2), change in ownership does not include:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of Section 64.

In this case, since corporation B is the wholly-owned subsidiary of corporation A, the proposed transfer of partnership interest from A to B will merely effect a change in A's method of holding title to its partnership interest, with proportional beneficial ownership interests in both the partnership and the underlying real property effectively remaining the same after the transfer. Therefore, if the

proposed transfer does not qualify for exclusion from change in ownership consequences under section 64(b), it should nevertheless qualify for exclusion under section 62(a)(2).<sup>1/</sup>

Hypothetical No. 2

Facts

1. A property is subject to a 50-year lease, with 35 years remaining.
2. Corporation A is the owner of the property and the lessor.
3. Corporation B is the lessee.
4. Corporation B is the wholly-owned subsidiary of corporation A.
5. The parties propose to (1) terminate the lease and (2) transfer the leasehold back to the lessor.

Law and Analysis

Your hypothetical transaction will result not only in the transfer of a leasehold interest with a remaining term of 35 years, but also in the termination of a lease with an original term in excess of 35 years. The termination will occur either through the express agreement of the parties or as a consequence of the merger of the lessor's and lessee's interests in the leasehold. Therefore, a change in ownership will result under section 61(c)(1) both on account of the lease transfer and lease termination unless an exclusion is found to be applicable.

Section 64(b) provides that "any transfer of real property among members of an affiliated group...shall not be a change of ownership." The definition of real property includes the possession of or right to possession of land and improvements. (Sections 104 and 105.) Therefore, real property leases are considered real property for purposes of section 64(b). Further, since corporation B is the wholly-owned subsidiary of corporation A, the two corporations are members of an affiliated group within the meaning of section 64(b).

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<sup>1/</sup> The provisions of section 62(a)(2) do not apply to transfers also excluded from change in ownership under section 64(b). (Section 62(a)(2).)

Therefore, section 64(b) would appear to apply to the leasehold transfer. Since corporation B is proposing to transfer the leasehold to its affiliate, corporation A, the transfer will be excluded from change in ownership consequences.

However, it is not clear that section 64(b) would also apply to the resulting lease termination. The legislature treated lease transfers and lease terminations separately and distinctly in section 61(c)(1). It is, therefore, not certain that the exclusion for real property transfers between affiliates set forth in section 64(b) is applicable to a lease termination which results from a lease transfer between affiliates.

Based upon the express language of section 61(c)(1), an argument can be made that the legislature intended that all terminations of leases with original terms of 35 years or more are to result in change in ownership of the demised property, regardless of whether or not an exclusion might otherwise apply.

In any event, it is preferable to be presented with the circumstances of an actual transaction prior to reaching a conclusion in a close case. Therefore, for the time being, we will defer our opinion on the possible application of the section 64(b) exclusion to lease terminations resulting from transfers of the lessee's leasehold interest.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county.

Yours very truly,



Robert W. Lambert  
Tax Counsel

RWL:jd  
3474H

cc: Mr. John Hagerty  
Mr. Verne Walton

**Memorandum****To :** Mr. Randy Bertholf --**Date:** March 23, 1994**From :** Kristine Cazadd**Subject:** Modified Opinion: Change in Ownership - 100% Stock Transfer,  
Co., DBA Co.

This is in further response to your request received on February 9, 1994, and a modification of one issue in our opinion set forth in the Memorandum to you dated March 3, 1994, (attached) concerning the transaction recorded on a recent Statement of Change in Control & Ownership of Legal Entities. The circumstances, which are the same as those described in our previous Memorandum, are as follows:

1. ("RF, Inc.") was a holding company created on June 17, 1987, which owned three subsidiaries and three classes of capital stock. Under its Articles of Incorporation, the holders of a majority of its Class B stock had the right to elect the director of RF, Inc. Class B. Further, under the terms of a shareholders' agreement entered into among all of the RF, Inc. shareholders and its subsidiaries, the director of RF, Inc. Class B had the exclusive authority to direct all voting of any and all stock owned by RF, Inc. in ----- Company ("PO Co."), which is one of its subsidiaries.
2. From its inception, ("DRF") owned 100% of the RF, Inc. Class B stock, and therefore, had the sole right to elect the Class B director and to direct all voting of the RF, Inc. stock in PO Co. Accordingly, DRF held two positions: (a) he was the Class B director, and (b) he was the president and director in control of PO Co.
3. On December 31, 1992, a corporate reorganization occurred whereby DRF tendered all of his RF, Inc. Class B stock to RF, Inc. RF, Inc. canceled the Class B stock and issued to DRF in exchange all of the issued and outstanding stock in PO Co. Thus, although PO Co. changed names, DRF

continued to own 100% of the PO Co. stock and to have the exclusive right to vote the PO Co. stock and to elect its directors.

In our March 3, 1994 Memorandum, we stated that the reorganization and stock transfer which occurred on December 31, 1992, is **excluded** from change in ownership because of the application of Section 62, subdivision (a)(2) to the transaction. This memorandum is not intended to alter that conclusion. However, we also stated that the exclusion from change in ownership provided under Section 64, subdivision (b) for transfers between **affiliated** corporations, was not applicable, because this transaction is not an IRC 368 reorganization, nor is it a transfer of real property among members of an affiliated group. Although we remain convinced that Section 64, subdivision (b) is not applicable, we believe that the reason stated in our March 3, Memorandum was incorrect.

After further consideration in view of the facts, it is our opinion that the absence of an IRC 368 reorganization under Section 64, subdivision (b), would not prevent the application of the exclusion, but the failure of the entities to remain affiliated after the transfer would.

With regard to the corporate **reorganization** requirement under Section 64, subdivision (b), the adopted interpretation under Property Tax Rule 462, subdivision (j)(4)(A) provides that a reorganization, e.g., a reorganization under IRC 368, is not mandated as a qualification for the exclusion.

As you are aware, Section 64, subdivision (b) provides in pertinent part that:

Any corporate reorganization, where all of the corporations involved are members of an affiliated group, and which qualifies as a reorganization under Section 368 of the United States Internal Revenue Code and which is accepted as a nontaxable event among similar California statutes, or any transfer of real property among members of an affiliated group...shall not be a change in ownership. The taxpayer shall furnish proof, under penalty of perjury, to the assessor that the transfer meets the requirements of this subdivision.

For purposes of this subdivision "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if:

(1) One hundred percent of the voting stock, exclusive of any share owned by directors, of each of the corporations, except the parent corporation, is owned by one or more of the other corporations; and

(2) The common parent owns, directly, 100 percent of the voting stock, exclusive of any share owned by directors, of at least one of the other corporations.

However, the interpretation of the foregoing statute in Rule 462, subdivision (j)(4)(A) contains no mention of any reorganization, including a reorganization under Section 368 of the United States Internal Revenue Code. Rather, the prerequisite under the Rule for the transfer to qualify for the exclusion under Section 64, subdivision (b), is that the corporations are and remain affiliated.

The applicable provisions in Rule 462, subdivision (j) in subparagraphs (3) and (4) state the following:

(3) Except as otherwise provided in subdivision (4), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity."

(4) Exceptions:

(A) When any corporation, partnership, other legal entity or person:

(i) obtains direct or indirect ownership or control of more than 50 percent of the voting stock in any corporation which is not a member of the same affiliated group of corporations as described in (2)(A),...

Since the foregoing rule was adopted by the Board without referencing the IRC 368 reorganization requirement, our position is that the rule provisions express the correct interpretation of Section 64, subdivision (b). The IRC 368 reorganization requirement reflected in subdivision (h) of

Section 64 is satisfied if the corporations are members of the "same affiliated group."

With regard to **affiliation**, however, the rule **does** require that the corporations **must** be members of the same affiliated group of corporations as described in (2) (A) of Section 64, subdivision (b). The meaning of the phrase "members of an affiliated group" was recently determined by the Court of Appeals in Pueblos Del Rio South v. City of San Diego (1989) 209 Cal.App.3d 893, 257 Cal.Rptr. 578. The Court held that "the ordinary common sense meaning of the phrase" is one that requires affiliation from the beginning until the end of the transaction. Specifically, the Court stated that the corporate reorganization in that case did not qualify for the exclusion under Section 64, subdivision (b), because the entities "did not continue to be affiliated after the transaction, which is a yardstick for measuring whether corporate entities qualify" for this exclusion.

The circumstances described herein appear to be similar to those in Pueblos Del Rio South v. City of San Diego, supra., in that the corporations are **affiliated** at the beginning of the transfer but not afterward. Initially, RF, Inc. is the common parent corporation of PO Co. through its 100% stock ownership (of Class B stock) in PO Co., exclusive of the shares owned by DRF. However, during the reorganization when RF, Inc. canceled the Class B stock and issued to DRF all of the outstanding stock in PO Co., RF, Inc. is no longer the parent corporation of PO Co. Therefore, the exclusion under Section 64, subdivision (b), that a corporate stock transfer is not a change in ownership, is **not applicable** since RF, Inc. and PO Co. **are not** members of the same affiliated group following the transfer.

Please note once again, however, that the provisions under Section 62, subdivision (a) (2), which we stated to be applicable to exclude the transfer from change in ownership in our March 3, 1994 Memorandum **continue** to apply, since DRF remained the owner of 100% of the stock in PO Co. both before and after the transfer. Therefore, the analysis of Section 62, subdivision (a) (2), as well as the future application of Section 64, subdivision (d), contained in our March 3 Memorandum remain unchanged.